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June 10, 2008

Honorable Christopher Cox, Chairman
Commissioner Paul S. Atkins
Commissioner Kathleen L. Casey
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Subject: Credit Rating Modifiers

Dear Chairman Cox, Commissioner Atkins, and Commissioner Casey:

We write this letter on behalf of the Securities Industry and Financial Markets Association (SIFMA)¹ Credit Rating Agency Task Force. The investor-led task force is comprised of 33 individuals from the US, Europe, and Asia, and includes asset managers, underwriters, and issuers. It has been designated by the President's Working Group on Financial Markets as the private-sector group to provide the PWG with industry recommendations on credit rating matters (as called for in the PWG's March 2008 Policy Statement on Financial Market Development). The task force is also working with credit rating agencies, with the goal of developing jointly agreed-upon recommendations. We are the Co-Chairs of the task force.²

This letter discusses task force concerns as to possible serious adverse and unintended consequences for our markets if the existing credit rating scales are changed. We anticipate that such a change could further damage our already unsettled capital markets, impair capital raising (for student loans, auto loans, credit cards, mortgages, and the like), and lead to the sudden sale of structured finance securities, at fire-sale prices, into an already highly illiquid market at a time when our financial markets can ill afford such an unnecessary shock to their system. We suggest below how to, instead, build greater transparency into the ratings process without the risk of adversely impacting capital raising and our financial markets.

One notion that has been raised recently by various regulators and organizations, including the SEC staff and IOSCO, is the possibility of appending a suffix to ratings of certain issues to better identify the nature of those issues. These are sometimes referred to as "credit rating modifiers." The discussion of modifiers has focused largely on structured finance securities. Thus, a "AAA" structured finance issue would now be designated "AAA-SF." The goal, as we understand it, is greater transparency.

¹ SIFMA brings together the shared interests of more than 650 securities firms, banks, and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services, and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington, DC, and London, and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

² More information on the task force, including a roster of task force members, can be found at http://www.sifma.org/capital_markets/cra-taskforce.shtml.

Limited Benefit. We strongly support enhanced transparency and disclosure. In fact, our task force is of the view that the limited transparency in today's ratings process is the number one cause of the ratings problems that the markets have experienced of late.

We believe, however, that this specific proposal would not lead to greater transparency. We fail to see any benefit in the modifier proposal – beyond a cosmetic one. Structured finance issues are typically purchased by Qualified Institutional Buyers (“QIBs”), that have \$100 million or more of assets under their management. These are highly sophisticated purchasers that would gain very little new information from an appended “SF.”

Potential Negative Consequences. On the other hand, there could be a significant cost. Changing rating scales could have the following negative unintended consequences:

- **Investment Guidelines & Embedded Regulations; Liquidity Impact.** By changing the rating itself, the modifier proposal may force asset managers whose purchases are limited by carefully worded investment guidelines to now sell off structured finance securities into an already illiquid market (depending, of course, on the precise language of the individual guidelines). Also, purchases of such securities might well be restricted, pending completion of a time-consuming guideline-revision process.

The reason for this is that typically investment guidelines mandate that purchases consist of, for example, “AAA” securities. Under the suggested approach, those same securities would now be referred to by a new symbol (AAA-SF) that does not explicitly appear in any existing guidelines. Asset managers could therefore be forced (depending on the specific language of their standing instructions) to sell those structured finance securities which they are already holding, if their investment guidelines do not refer to the “AAA-SF” symbol.

This problem is not restricted to investment guidelines. It is also embedded in what we believe are easily tens of thousands of SEC rules and other US and non-US laws, state insurance regulations, pension legislation, Basel II, compliance programs, bilateral agreements, board of director minutes, other corporate documents, and the like that refer to existing rating categories. To change all of these items within which such reliance is embedded can , be expected as a practical matter to take years to accomplish

- **Differentiation among Structured Products.** Another unintended consequence could be the impairment of structured products that heretofore have performed well, and have been immune from the precipitous ratings downgrades experienced by sub-prime RMBS and CDOs of asset backed securities; specifically, credit card, auto loan, and prime mortgage securitizations. The modifier proposal does not allow for differentiation of underlying collateral in the securitization market. An unduly blunt identifier of “problem” securities, it therefore actually inhibits greater transparency. By grouping these disparate types of structured finance issues together, this approach might well increase the possibility that investment boards of institutions such as pension plans and foundations would establish blanket policies to not own any securities with “SF” modifiers. The result could be a substantial reduction in investment funds committed to credit card, auto loan, and prime mortgage asset-backed debt – resulting in higher borrowing rates to consumers.

- **Systems Concerns.** The modifier proposal also raises systems issues, as to which it is not apparent that any serious consideration has been given. Financial firms rely on extensive compliance and other systems that have been set up to handle the existing ratings. The firms' computer fields can accommodate the current ratings.

Firms involved in securities issuance, underwriting, investment, and custody may, however, not have systems capable of accepting and interpreting the new ratings that are being considered, with fields wide enough to handle the extra characters that such a new, expanded rating scheme would require. Similar major industry systems concerns such as Y2K systems disruptions have of course been averted, but only at considerable expense.

Suggested Approach: Require Greater Transparency, without Rating Modifiers. Rather than mandate a rating modifier that simply identifies a type of security, our strong alternative suggestion is that reforms should require credit rating agencies to add additional information, explaining the basis of the rating, to the agencies' pre-sale rating reports. A number of major institutional investors have expressed strong support for this approach. Enhanced disclosure of collateral credit quality characteristics by the credit ratings agencies (such as inputs to ratings, methodologies and exceptions applied in establishing ratings, and the sensitivities of ratings to key variables) seems, to us, to be a much more informative way to educate investors. It would provide specific additional information that could be used by investors, if they so desired, for investment decision analytics and for enhanced risk control decisions. A number of credit rating agencies have, in fact, suggested just such an approach in response to investor feedback.

That greater transparency could come in any of a number of formats, and contain various types of information. Volatility, loss sensitivity, and initial collateral loss expectations for structured products are examples of what might be shared, in addition of course to the fact that the issue is, where this is the case, a structured product. If such information were conveyed in a clear manner that increases transparency, we would very much support it. Such an approach would also, we believe, fit within the strictures of Recommendation 17 of the May 2008 IOSCO Final Report on the Role of Credit Rating Agencies in Structured Finance Markets.

We appreciate your consideration of our views.³

Very truly yours,

Deborah A. Cunningham, CFA

Boyce I. Greer

SIFMA CRA Task Force Co-Chair

SIFMA CRA Task Force Co-Chair

Chief Investment Officer
Federated Investors

President, Fixed Income and Asset Allocation
Fidelity Management & Research Company

³ The views expressed in this letter, to the effect that it would be undesirable to change ratings scales in a manner such as that which is being contemplated, are broadly consistent with positions taken by other industry organizations, such as the Commercial Mortgage Securities Association, International Banking Federation, Mortgage Bankers Association, National Association of Realtors, and Real Estate Roundtable, Zentraler Kreditausschuss (the German Banking Industry Associations), and previously taken by SIFMA and SIFMA affiliates the American Securitization Forum and the European Securitisation Forum.